Guernsey Financial Services Commission

Feedback on the Commission's Consultation Paper on Amendments to the Banking Rules on Accounts, Disclosure & Large Exposures

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Background

On the 16 March 2021 the Commission published a consultation paper on its proposed Accounts, Disclosure and Reporting Rules and its Large Exposure Rules, to be issued under the Banking Supervision (Bailiwick of Guernsey) Law, 2020. The Consultation period ran for 8 weeks until 11 May 2021.

There was a healthy response to the Consultation Paper which saw 7 responses. This included 6 licensees and one industry body.

Details regarding the rules and accompanying guidance can be found on the Consultation Hub.

Consultation Hub - Amendments to the Banking Rules on Accounts. Disclosure & Large Exposures

Accounts, Disclosure and Reporting Rules

What was the general message in the feedback?

All of the respondents were in favour of the Commission specifying the accounting standards that licensees must use when preparing their audited accounts. Respondents also agreed that the standards specified in the Rules were appropriate as they matched the standards they were currently using.

Some respondents asked for clarity on the status of two guidance notes ("Guidelines to Banks and their Auditors" and "Guidelines to Banks and their Auditors issued under s1(b)(ii) of the Banking Supervision (Accounts) Rules, 1994") along with abridged accounts once the new Rules are in force. The two guidance notes, which provided templates for audited accounts and abridged accounts, will be withdrawn once the new Rules come into effect as they are outdated. The new rules do not make reference to abridged accounts so licensees should prepare their audited accounts in line with the accounting standards specified.

In general, most respondents broadly agreed with the Commission's proposals on the publication of audited accounts and disclosure of a small number of key metrics. Some respondents commented that they already provide this information, either through publication or on request. Others noted that this was standard practice in other jurisdictions in which their group operated. A small number of respondents noted that there would be some operational or practical issues with the Commission's proposals, but that they were not insurmountable.

What is the Commission going to do next?

The Commission intends to go ahead and publish its Accounts, Disclosure and Reporting Rules with some minor amendments following the consideration of the valuable feedback provided.

Please find below comments and actions taken in relation to some of the feedback we have received.

Specific Feedback and Changes

1. <u>Liquidity Coverage Ratio (LCR) Disclosure</u>

   Some respondents commented that the LCR can be quite variable and were concerned that by disclosing the LCR as at year end it may give stakeholders the incorrect impression that the bank had a liquidity issue if, for example, its LCR fell from 250% to 200% year to year. Giving banks the option of disclosing the LCR as a 12 month average was proposed as a solution.

   a. The Commission acknowledges that the LCR can be variable. However, the Commission does not intend to change the requirement to disclose the year end figure. This approach is simpler, matches the disclosure requirements for the other key metrics and will maintain comparability between all licensees.

In addition, as the Guidance explains, licensees can disclose information above the minimum required by the Rules but when this includes average values, they must include the method of calculation.

2. Net Stable Funding Ratio (NSFR) Disclosure

Some respondents commented that it was inappropriate for the Commission to require the disclosure of the NSFR as the Commission has not set a regulatory minimum level for the NSFR.

a. The Commission agrees that it would be inappropriate to require disclosure of the NSFR at this time, as it has not set a minimum level. However, in the event that the Commission does set a minimum NSFR, licensees will then be required to disclose it

   The Commission has no current plans to introduce a minimum NSFR, given the delays in its wider adoption in other jurisdictions. The Commission may consider introducing a minimum NSFR in the future if, for example, full Basel III compliance was a condition to the Bailiwick joining a trade agreement or when it becomes more widely implemented. The Commission will give licensees at least six months' notice before implementing a minimum NSFR requirement.

   The Rules and Guidance have been updated to make it clear that the NSFR does not need to be disclosed.

3. Rule 2.3.4

Rule 2.3.4 has been removed as it was included in error from an earlier draft. Rule 2.1.4(1)(c) has also been removed as it referenced Rule 2.3.4. This has no material impact on the meaning of the Rules.

Large Exposure Rules

What was the general message of the feedback?

With regard to the proposed reduction in the interbank large exposure limit, generally licensees noted that they would be able to implement the change. However, some licensees explained that they would need to increase the number of interbank counterparties they used due to the reduced exposure limits. They also noted that they may need to use counterparties with a lower credit rating than their current interbank counterparties, leading to an increase in credit risk.

The Commission acknowledges that licensees may need to increase their number of interbank counterparties in order to comply with the new rules and that this may lead to a reduction in the credit quality of those counterparties. The aim of the Commission's Large Exposure Rules is to reduce credit concentration risk so that the failure of a single counterparty will not threaten the ongoing viability of the bank. If a small increase in credit risk is required to achieve that aim, the Commission views that as a reasonable trade-off.

A number of respondents suggested that the Commission adopt a version of the UK and EU's approach to inter-bank exposures. Under the Commission's proposed Large Exposure Rules, inter-bank exposures would be subject to a maximum limit of 50% of the bank's regulatory capital. In the EU/UK the exposure limit is instead the higher of EUR 150m or 25% of capital. The respondents proposed that the Commission could adopt something similar, albeit with a lower absolute value that was more appropriate to the scale of the Guernsey banking sector (such as £60m, for example).

The Commission disagrees with this proposal as it would, in effect, work against its aim of reducing the risk to Guernsey banks, and their depositors, were one of their interbank counterparties to fail. Under these proposals, some banks would be able to maintain interbank exposures of 100% or more of capital, thus retaining the kind of "single point of failure" concentration risks that the Large Exposure Rules are intended to remedy. Also, the Commission has already moved away from the 25% of capital exposure limit set in the Basel Framework to 50% of capital in order to ensure its policy meets local conditions.

With regards to the proposed new upstreaming limit of 100% of capital, the majority of respondents noted that they already operated at a similar limit and as such the new requirements would only require small adjustments. However, some respondents explained that they would, at times, receive large deposit inflows on short notice and having a higher upstreaming limit helped in managing those sudden inflows. A small number of respondents also noted that they would need to make more substantial changes.

The Commission acknowledges the above issue around sudden deposit inflows and agrees, as set out below in more detail, that short term limit exceptions may occur on an occasional rather than exceptional basis. In addition, the Commission retains its ability, where appropriate, to issue derogations, where they satisfy its key policy objectives.

What is the Commission going to do next?

The Commission intends to go ahead and publish its Large Exposure Rules with some amendments following the consideration of the valuable feedback provided.

As stated in the Consultation Paper, there will be a 12 month implementation period.

Please find below comments and actions taken in relation to some of the feedback we have received.

Specific Feedback and Changes

1. Rule 3.3 - Eligible Credit Risk Mitigation techniques

   A number of respondents noted that it was not clear what counted as an eligible credit risk mitigation technique in the proposed rules.

   a. The Commission has amended Rule 3.3 to make it clear that eligible credit risk mitigation techniques consist of collateral, on-balance sheet netting, guarantees and credit derivatives, as set out in the standardised approach to credit risk[1].

   b. The guidance under Rule 3.3 has also been updated to explain that unfunded risk participation agreements should be treated as guarantees.

   c. Rule 3.3(3) has been amended to correct a drafting error. It now states that when a licensee uses a credit risk mitigation technique for an exposure under the standardised approach to credit risk, it must do the same for large exposure purposes. This Rule helps ensure that all of a licensee's exposures are included in the large exposure framework.

2. Rule 5.1 – Exposures to group entities

   Some respondents commented that the requirement that all exposures to group entities must mature in 6 months or less would cause them significant difficulties as they carry out interest rate or FX swaps through their parent, either to manage their balance sheet or on behalf of clients.

   a. The Commission has amended rule 5.1(3) so that the 6 month maturity limit only applies to on-balance sheet exposures that are not subject to credit risk mitigation.

3. Rule 5.2(7) and (8)

   These rules concerned on-balance sheet netting and have been deleted as their subject matter is now covered by Rule 3.3

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[1] The standardised approach to credit risk defines how banks must calculate their credit risk capital requirements. It is discussed in more detail in the Consultation Paper, here. It is defined in the Commission's BSL/2 Module 1 Guidance, here.

4. Rule 6.4 – Breaches of limits

Several respondents explained that the rules allowing for temporary, short duration limit excesses without breaching the Rules, while helpful, would not work as intended for them. This rule is intended to allow licensees more flexibility in dealing with things like large deposit inflows that come in late in the day and/or with very little notice. One of the conditions for applying this exemption is that the excess must occur due to exceptional circumstances. The respondents argued that it was unlikely that these kinds of events would be 'exceptional circumstances' for them. Due to the nature of their business models, while they do not occur constantly, these kinds of events do happen fairly often (once a month, for example).

   a. The Commission has amended Rule 6.4(2)(c) to refer to excesses that occur on an occasional basis. The reporting requirements have also been updated to require quarterly reporting instead of reporting within one week of the event. The associated guidance notes have also been updated.

5. Schedule 3 – Connected Counterparties

The guidance on economic interconnectedness has been amended to more closely reflect the wording in the Basel Framework. For the avoidance of doubt, the meaning of this section has not changed.